

COMMONWEALTH OF KENTUCKY  
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of:

ADJUSTMENT OF RATES OF THE )  
LEE ANGLE COMPANY, INC. )

CASE NO. 7658

O R D E R

Preface

On November 14, 1979, Lee Angle Company, Inc., hereinafter referred to as the "Utility", filed with this Commission a duly verified application seeking an adjustment of its sewage rate; proposing an effective date of December 1, 1979. This proposed date did not, however, meet the 20-day notice requirement of KRS 278.180 and, by amendment to the application, was changed to January 1, 1980. The Commission, under authority of KRS 278.190, ordered the proposed rate suspended for five months beginning January 1, 1980.

The case was set for hearing at the Commission's Offices in Frankfort, Kentucky on February 12, 1980. All parties of interest were duly notified. The Division of Consumer Intervention of the Attorney General's Office and residents of Executive Park Subdivision are intervenors of record in this matter. The testimony of a number of said residents is a part of the record in this matter.

The revised exhibits and revised rate proposal as introduced by the Utility at the February 12, 1980 hearing would have, if utilized, required a complete restart and a new case. For this reason, they were excluded from consideration in this case.

At the hearing, certain requests for additional information were made by the Commission Staff. Pursuant to the conclusion that all requested information and other pertinent matters have been filed, the entire matter is now considered to be fully submitted for a final determination by this Commission.

### Test Period

The Utility has selected the twelve month period ending September 30, 1979, as the "Test-Year" and has submitted tabulations of revenues and expenses for this period including proforma adjustments thereto for the Commission's consideration in the determination of rate adjustments. Said tabulations along with those found reasonable by this Commission are included in Appendix "C" of this Order.

### Rate Determination

While the Commission has traditionally considered the original cost of utility plant, the net investment, the capital structure, the cost of reproduction and the going concern in the determination of fair, just, and reasonable rates, it's experience in the establishment or adjustment of rates for sewage utilities has indicated that these valuation methods are not always appropriate. Sewage utilities are unique to the extent that the cost of facilities has usually been included in the cost of the individual lot. The owner and/or operator of the utility is, in many instances, the developer of the real estate. There are numerous instances of title changing hands prior to the effective date of Commission jurisdiction (January 1, 1975). Further, the Commission has found that the books, records and accounts of many of these utilities are incomplete. In such instances, the fixing of rates on the above methods of valuation is impossible. The Commission is, therefore, of the opinion that the "Operating Ratio Method"<sup>(1)</sup> should be utilized in rate-making determinations for sewage utilities although it is recognized that there may be instances where another method could be more valid.

### Findings In This Matter

The Commission, after consideration of all the evidence of record and being advised, is of the opinion and finds:

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(1) Operating ratio is defined as the ratio of expenses, including depreciation and taxes to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{depreciation} + \text{taxes}}{\text{Gross Revenues}}$$

1. That, in this instance, the determination of rates and revenue requirements should be based on the operating ratio method.

2. That the rate prescribed and set forth in Appendix "A", attached hereto and made a part hereof, is the fair, just, and reasonable rate to be charged for sewage services rendered by the Utility, in the Executive Park Subdivision of Madison County, Kentucky.

3. That an operating ratio of 0.88 results from the proforma revenues and expenses as adjusted and provides a reasonable return margin <sup>(2)</sup> in this instance.

4. That the rate proposed by the Utility is unfair, unjust, and unreasonable in that it would produce revenues in excess of those found reasonable herein and should be denied.

5. In past years when depreciation on contributed property was not a significant matter to rate making, it was traditionally included in the rate-making process. Today, however, the value of contributed property is frequently more than the value of non-contributed property, and the matter of a depreciation allowance thereon is a significant matter to rate making. Further, it is common practice for a builder or developer to construct water and sewage facilities that add to the value and salability of his subdivision lots and to expense this investment cost in the sale price of these lots or, as an alternative, to donate these facilities to a utility company.

The Commission is of the opinion and finds that depreciation on contributed property for water and sewage utilities is not justified and should not be included in rate-making determinations for these utilities. The cases and decisions listed in Appendix "B", attached hereto and made a part hereof, are hereby referenced as substantiation of the Commission's position in this matter.

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(2) Return margin is the amount remaining for the payment of a return on the investment of the security holders.

6. According to the record and testimony in this matter, the Utility increased its monthly rate from \$6.00 to \$7.00 on July 1, 1977 and subsequently from \$7.00 to \$8.00 on February 1, 1979 without seeking or obtaining Commission approval thereof. All monies collected by the Utility in excess of \$6.00 per month per customer should be refunded to those parties from whom the said excess monies were collected. Further, that a plan and schedule for making the said refund should be submitted to the Commission within thirty (30) days of the date of this Order and a certificate of compliance, stating that all refunds have been made should be filed with this Commission within thirty (30) days of completion of said refund.

7. That the Commission, after consideration of the tabulation of test-year and projected revenues and expenses submitted by the Utility, concludes that these revenues, expenses and adjustments can be summarized as shown in Appendix "C", attached hereto and made a part hereof. On the basis of the said Appendix "C" tabulation, the Commission further concludes that annual revenues in the amount of \$8,889 are necessary and will permit the Utility to meet its reasonable expenses for providing sewage collection and disposal service to 50 customers.

8. That the Commission, in order to comply with Section (3) of KRS 278.190 <sup>(3)</sup>, is obligated to render a decision in this matter no later than September 14, 1980. Further, that the date this Order is entered will be within the five-month suspension period imposed by this Commission; and the Utility should not implement its proposed rate after expiration of said suspension period.

9. That although the Commission has requested the Applicant to obtain a "Third Party Beneficiary Agreement" and to file a copy of this agreement with the Commission, the Applicant, as of the date of this Order, has not complied with this request.

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(3) Section (3) of KRS 278.190 stipulates that the Commission in any proceeding involving a proposed increase in rates or charges is obligated to decide the matter as speedily as possible and, in any event, not later than ten months after the date of the filing of the application. The application in this matter was filed November 14, 1979.

10. That the granting of any rate increase in this matter should be contingent upon the Applicant obtaining a Third Party Beneficiary Agreement, or an acceptable alternative agreement whereby the continuity of service to its customers will be guaranteed. Further, that a copy of said agreement should be furnished to the Commission within sixty (60) days of the date of this Order.

11. The Utility in order to provide for better protection of its property and for improved public safety has proposed the construction of a security fence enclosure for the treatment plant. The Commission concurs in this proposal and finds the estimated cost of \$1150 to be reasonable. Further that the actual cost of this work should be capitalized and depreciated at a rate of 5% per year. Further that upon completion of the said enclosure, the Utility will qualify for a more reasonable premium for liability insurance; and said premium should these be allowed as an annual expense for rate-making purposes.

12. That the annual costs to the Utility for depreciation of the enclosure fence of \$57.50 and \$592.00 for insurance should be included in the sewage service rate found reasonable by this Commission; but only after completion of the proposed fence, obtaining insurance coverage, and the filing of acceptable documentation of these matters with this Commission.

#### ORDERS IN THIS MATTER

The Commission on the basis of the matters hereinbefore set forth and the evidentiary record in this case:

HEREBY ORDERS That the "Effective Date" for the rate set forth in Appendix "A" shall be the date on which the Utility files with the Commission an acceptable "Third Party Beneficiary Agreement" or an acceptable alternative agreement whereby the continuity of service to its customers will be guaranteed. Further, that the Utility shall be allowed sixty (60) days from the date of this Order to file a copy of said agreement with the Commission. Further, that the Utility's failure to file said agreement within

the specified sixty (60) days shall render the rate prescribed by this Order null and void, and the Utility's rate for services rendered shall remain the same as the rate in effect under approval of this Commission on the date the application in this matter was filed with the Commission.

IT IS FURTHER ORDERED That the rate prescribed and set forth in Appendix "A", attached hereto and made a part hereof shall be fixed as the fair, just and reasonable rate of the Utility to become effective for services rendered on and after the "Effective Date" as hereinbefore prescribed.

IT IS FURTHER ORDERED That the rate sought by the Utility be and the same is hereby denied.

IT IS FURTHER ORDERED That the Utility shall, in accordance with finding Number 6 of this Order, make refunds to all parties from which excess monies were collected by means of its \$7.00 & \$8.00 monthly rate. Said refund shall be in accordance with KRS 278.190 (4). Further, that a plan and schedule for making the said refund shall be submitted to the Commission within thirty (30) days of the date of this Order and a certificate of compliance, stating that all refunds have been made, filed with this Commission within thirty (30) days of completion of said refund.

IT IS FURTHER ORDERED that satisfactory completion of the proposed enclosure fence for the treatment plant and the obtaining of insurance on Utility property as set forth in the record in this matter shall qualify the Utility for an additional rate adjustment of \$1.23 per month per customer as set forth in Appendix "A" attached hereto and made a part hereof. Further, that the effective date for the said adjustment shall be the date the Utility provides acceptable documentation of qualification for this adjustment to this Commission.

IT IS FURTHER ORDERED That the applicant shall file with the Commission, within thirty (30) days of the "Effective Date" as hereinbefore prescribed, its revised tariff sheets setting forth the rate shown in Appendix "A". Further, that a copy of the Applicant's "Rules and Regulations" for providing service to its customers shall be filed with said tariff sheets.

Done at Frankfort, Kentucky this 30th day of May, 1980.

UTILITY REGULATORY COMMISSION

Richard S. Taylor  
Chairman

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Vice Chairman

Murray Ray Oaken  
Commissioner

ATTEST:

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Secretary

APPENDIX "A"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7658 DATED MAY 30, 1980.

The following rates are prescribed for sewage disposal services rendered to all residential customers served by the Lee Angle Company, Inc. in Madison County, Kentucky.

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
Single-Family Residential	\$14.81 Per Residence

The following rate will be applicable after completion of the proposed enclosure fence, obtaining insurance on the Utility property, and the filing of acceptable documentation thereof, with this Commission.

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
Single-Family Residential	\$16.04 Per Residence



APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7658 DATED MAY 30, 1980.

A listing of cases and decisions that substantiate finding  
number

- (1) 28 U.S.C. s 362(c) (1976).

Dealing with the Basis to Corporations in Reorganization. It states in part that property contributed by nonstockholders to a corporation has a zero basis.

- (2) Easter v. C.I.R., 338 F.2d 968 (4th Cir. 1964).

Taxpayers are not allowed to recoup, by means of depreciation deductions, an investment in depreciable assets made by a stranger.

- (3) Martigney Creek Sewer Co., (Mo. Pub. Serv. Comm., Case No. 17,117) (November 26, 1971).

For rate making purposes a sewer company should not be allowed to treat depreciation on contributed plant as an operating expense.

- (4) Re Incline Village General Improv. Dist., I & S 558, I & S 559, (Nev. Pub. Serv. Comm., May 14, 1970).

Where a general improvement district sought to increase water rates, the Commission could not consider depreciation expense on the district's plant because all of the plant had been contributed by members of the district.

- (5) Princess Anne Utilities Corp. v. Virginia ex. rel. State Corp. Commission, 179 SE 2d 714, (Va. 1971).

A depreciation allowance on contributions in aid of construction was not allowed to a sewer company operating in a state following the "original cost" rule in determining rate base because the company made no investment in the property, and had nothing to recover by depreciating the donated property.

# APPENDIX "C"

## APPENDIX TO AN ORDER OF THE UTILITY REGULATORY COMMISSION IN CASE NO. 7658 DATED MAY 30, 1980.

In accordance with Finding No. 8, the following tabulation is the Commission summary of the "Test-Year" and projected annual revenues and expenses for the Utility's 30,000 GPD sewage collection and treatment system for providing service to test-year and proforma customers.

(No. of Customers)	Test-Year <sup>(1)</sup> Ending 9/30/79 (45)	Proforma <sup>(1)</sup> Requested (50)	Proforma Found Reasonable (50)
<b>R E V E N U E S:</b>			
1. Sewage Service	\$4,431	\$18,207	\$8,889
2. Interest	3	-0-	-0-
Total Revenues	\$4,434	\$18,207	\$8,889
<b>E X P E N S E S:</b>			
1. Billing & Collecting			
(a) Labor	\$ -0-	\$ 300	\$ 300
(b) Postage	35	81	81(2)
2. Routine Maintenance	2,555	6,000	2,977(2)
3. Repairs	3,175	3,492	2,102(4)
4. Utilities	989	1,088	989(5)
5. Supplies	93	102	93(5)
6. E.P.A. Monitoring	-0-	3,000	600(3)
7. Depreciation	1,643	1,643	-0-(6)
8. Legal Services	-0-	100	100
9. Rate Case (\$1500/3 yrs.)	-0-	500	500
10. Taxes			
(a) General	192	-0-	-0-
(b) Sales	-0-	80	80
Total Expenses	\$8,682	\$16,386	\$7,822
Net Income (Loss)	(\$4,248)	\$ 1,821	\$1,067

- (1) Test Year and Proforma Requested Revenues and Expenses were taken from the Applicant's Comparative Income Statement (corrected) for the twelve month period ending September 30, 1979.
- (2) The allowance of \$2,977 for routine maintenance was based on six (6) hours labor per week plus transportation cost.
- (3) An expense of \$600 was allowed for E.P.A. Monitoring based on an outside company to do water quality testing every three (3) months at \$150.
- (4) The Applicant's Proforma Requested Expense of \$3,492 was reduced to \$2,102 based on actual costs incurred during the test year.
- (5) Allowances for these expenses were reduced to their respective test-year amounts as the requested increases were not adequately substantiated by the record in this matter.
- (6) Depreciation expenses were disallowed based on data furnished by the Applicant after the hearing stating that all costs will be recovered through the sale of lots.